THE ETHICS OF SPECULATION.

TAKEN in its narrowest sense, the word speculation describes transactions that are made for the sole purpose of getting a profit from changes in price. This is the sense in which it will be used in this paper. Furthermore, the discussion will be confined to operations on the stock and produce exchanges. The speculator, then, buys and sells property because he expects to realize a gain from changes in its price, not because he expects to be a sharer in its earnings. The reason that he does not intend to profit by the earnings of the property that he ostensibly buys and sells, is to be found in the fact that his control of the property will be either too brief to secure the actual earnings, or too indefinite to create earnings. The former is the usual case of speculation in stock, the latter, of speculation in produce.

Some examples will make clearer this distinction between the speculator and the ordinary investor or trader. The man who buys railway stocks merely to sell them in a few days at an expected advance, is a speculator; the man who buys them to hold permanently for the sake of the dividends that they will yield, is not a speculator. The former looks to price changes for his gains, the latter to property earnings. Again, two men buy wheat on the board of trade: the first is a miller who wants wheat to grind; the second is a speculator who has no particular use for wheat. He does not intend to change its form in any way or bring it nearer to the consumer; his interest in it is confined solely to its fluctuations in price. From these he expects to make his profit. The miller, on the other hand, will add utility to the wheat by converting it into flour. His profit will be in the nature of a payment for this productive and social service. In like manner, the dividends received by the genuine investor in railway stocks will be a return for the use of his capital in a productive business. Both he and the miller are producers of utility, while the speculative buyer of stocks, and the speculative buyer of wheat, add

nothing to the utility of any property—make no contribution to production.

Pure speculation on the exchanges differs, therefore, from ordinary trade and investment, in its effect upon the production of utility, and in the source of its gains. These are in reality two aspects of the same economic fact. It is also unique in the manner in which its contracts are completed, or "settled." I have spoken of the speculator as, *ostensibly* buying and selling. In purely speculative purchases and sales, there is no genuine *transfer* of goods. The stocks bought are not, in any adequate sense, brought into the possession and control of the purchaser, but are usually "carried" by his broker until they are sold. The exceptions to this rule are not of great importance, and need not concern us here. The produce bought—wheat, cotton, petroleum, etc.—is not moved an inch in any direction. When the buyer completes one of these transactions he merely receives or pays out a sum based on the extent to which the price of the goods in question has risen or fallen. The mechanism of these settlements falls outside the scope of this paper. It suffices to point out that speculative contracts are settled by a payment of price differences, instead of by a genuine delivery of goods. In effect and intention they are substantially wagers on the course of prices.

Indiscriminate apologists for speculation and the exchanges are fond of insisting on the productive services of so-called speculators who gather and store up goods during a period of plenty, and dispose of them during a period of scarcity, or who carry goods from a place where they are abundant to a place where they are in greater demand. Hence they conclude that speculation, *i. e.*, all speculation, is useful. Such reasoning betrays confusion of thought. With speculators in the sense just mentioned we have nothing to do in this place. Besides, their social worth is obvious. Nor are we concerned with the exchanges, as such. Their original function was a very necessary one, namely, to serve as meeting places for those who wished to buy and sell real goods. They still retain that function in so far as they constitute a market place for permanent investors, and for manufacturers and productive traders.

These productive transactions, however, have become subordinated to purely speculative operations, so that, according to conservative estimates, fully ninety per cent. of the business done on the exchanges is of the latter character.

Now this kind of speculation, as already pointed out is nonproductive. It creates no utility, either of time, place, or form; that is to say, it neither distributes goods over intervals of time, or space, nor puts them through any process of manufacture. Does it perform a social service of any kind? If it does there will arise a presumption that it is morally good.

Prof. Henry C. Emery, in what is without doubt the most thorough work on speculation written in English,* strongly maintains that organized speculation, of the kind that we are discussing, is of great service to legitimate trade. Since the market for great staples, like grain and cotton, so runs his argument, has become a world-market, the large dealers in these goods must not only buy, store, and move them, but also take extraordinary risks of changing prices. These risks are extraordinary because they extend over a long period of time, and are subject to world-wide trade conditions. What the dealers need, then, is "a distinct body of men to relieve them of the speculative element of their business." The professional operators on the produce exchanges constitute just such a class. The wheat merchant buys a quantity of wheat in the northwest for shipment to Liverpool, where he intends to sell it some time later. But the price of wheat may fall before that time arrives. Here arises the element of risk. To avoid it, he immediately sells to a speculator, for future delivery, an equal quantity of "paper" wheat. The delivery of this "paper" wheat, or rather, the settlement of this speculative contract, is to take place about the same time that his cargo of actual wheat is to be delivered and sold in Liverpool. If in the meantime the price of wheat falls he will lose on his actual wheat, but he will gain on his "paper" wheat. For when a man sells any commodity in the speculative market for future delivery, his interest is to have the price of that commodity fall. Thus

*"Speculation on the Stock and Produce Exchanges of the United States." (Macmillan.)

he gains the difference between the price of the article when he sold it and its price at the time of delivery, or settlement. Hence, by means of this "hedge" sale the wheat merchant is secured against loss on his cargo of actual wheat. Sales of this kind are a sort of insurance that lessen both the possibilities of great profit and the risks of great loss. It is said that nine-tenths of the wheat stored in the elevators of the northwest is "sold against" in this way.*

So much for speculation in produce: speculation in stocks, it is maintained, enables the small investor to have within reach a class of men "ready to assume all the risk of buying and selling his security, and a market that fixes prices by which he can intelligently invest." The army of professional speculators stand prepared at any time to buy or sell any kind of stocks that are at all marketable, while their incessant buying and selling keeps the market active, and the quotations of the different securities at their proper level. The whole function of organized speculation is summed up to be: taking the great risks of fluctuating values, reducing these fluctuations to a minimum, and providing an active market for produce and securities.

The obvious answer to the above argument is that traders in produce should take the risks of fluctuating prices themselves. At present, indeed, they seem unwilling to do so, because the speculators stand ready to do it for them. But it is difficult to see how the public would suffer if traders, importers, and manufactures were compelled to take all the risks incident to their business, instead of handing them over to a special class. Under such an arrangement many of them would doubtless go to the wall, but the community would be the gainer through the elimination of the unfit. Besides, there is reason to believe that the superior knowledge of market conditions possessed by the professional speculators, and their work in reducing the range of price fluctuations is very much overestimated. At any rate, there seems to be no good reason

*"Proceedings of Twelfth Annual Meeting of American Economic Association," p. 110.

why the capable dealer or manufacturer could not acquire a sufficient amount of this same knowledge and foresight. To set apart a body of men for the sole purpose of *dealing in risks* seems to be carrying the principle of division of labor unnecessarily far, especially when these men manage to charge the high price for their services that is obtained by the professional speculators of our produce exchanges.

As to stock speculators, it may be reasonably admitted that they know the true value of the various securities more accurately than the small investors, and that they are able to fix more correct prices than would be possible without their activity. Yet if there were no dealing in stocks, except for permanent investment, there would still be a stock market. That is to say, if there were no speculators, and if stocks were bought solely for the sake of their dividends, it would still be possible for an investor to buy them at quotations sufficiently correct and stable. This fact is exemplified to-day in the case of numerous securities that are not dealt in by speculators nor listed on the exchanges. It is worthy of note that two prominent German economists who maintain that the produce exchange is a necessary institution, declare that the stock exchange is "an unnecessary and injurious one."

The institution of organized speculation is not only of doubtful benefit to the community, but produces serious public evils. Only those who have expert knowledge of market conditions can, in the long run, make money on the exchanges. These are the prominent professional speculators, the "big operators," as they are often called. The great majority of all the others who speculate, namely, the outside public, either know nothing of the intricacies of the market, or rely on "inside information" that is worse than useless because misleading. Out of the losses of this class comes the greater part of the gains of the big operators. One proof of this is seen in the fact that when the general public and the small operators desert the exchanges after being fleeced, speculative activity is checked until such time as the "small fry" begin operations anew. And yet the general public continues to patronize the centers of speculation in ever increasing numbers, notwith-

standing the lessons of the past. Thus the chief losses of speculation are borne by those who can least afford to bear them.

Speculation absorbs a considerable amount of the community's capital and directive energy. It diverts money from productive enterprises, and engages the activity of men who, if removed from the unhealthy atmosphere of the exchanges, would be of great service to the world of industry. By holding out to its votaries the hope of getting rich quickly, it discourages industry and thrift, and makes men worshipers of the goddess of chance. It imbues thousands with the persuasion that acquiring wealth is a colossal game in which they are to be fortune's favorites. The career of the "Franklin Syndicate" in Brooklyn, in 1899, is a typical instance of the way in which those who have caught the speculative fever disregard the laws of probability and the laws of wealth. The promoters of this company agreed to pay ten per cent. per week on all deposits, pretending that they were enabled to do so through their "inside information" of the stock market. Within a few weeks they took in nearly one million dollars, showing how large is the number of people who regard the stock exchange as an institution that creates wealth without labor.

To the question that was asked above,—does speculation perform any social service? the correct answer, then, would seem to be in the negative. At any rate, its good features, which are problematical, are more than offset by its bad features, which are grave and unmistakable. Hence there is no reason to regard organized speculation as morally good because of any economic or social function that it exercises.

If the *institution* of speculation is at best of doubtful moral and social worth, what are we to say concerning the moral character of the *individual act* of speculating in stocks or produce? According to Funck-Brentano, speculation on the exchanges, although not highway robbery, is "robbery according to the rules of an art so refined that the keenest lawyer can not exactly determine the point where fraud begins and legality ceases." This condemnation, however, seems too sweep-

ing; for many of the transactions on the exchanges are made by men who have no intention of acting dishonestly. At the worst, they are actuated merely by the spirit of the gambler. But it is true that moral and immoral operations are often inextricably mingled, so that it is extremely difficult, no less for the moralist than the lawyer, to separate the good from the bad. For our purpose it will be best perhaps to point out the dishonesty of some of the more notorious practices and the extent to which they are followed, and then discuss the morality of speculative transactions that are entered into with the most upright intentions.

Under the régime of competition the natural and just value of goods of all kinds is determined ultimately by demands for consumption and for permanent investment. We may find fault with this anarchic determination of prices; we may complain that the movement of supply and demand often compels men to sell their property at a loss; yet so long as our economic structure is based on this system, so long as we live under the competitive régime, the natural movement of supply and demand (apart from the question of a living wage) must, generally speaking, be accepted as the only just regulator of values. Hence speculators morally are bound to take the exchange values of property as they find them. Any attempt to raise these values artificially, is an attempt to make purchasers pay more for property than it is worth; and any attempt to depress these values is an attempt to deprive owners of property of a just profit. Purchases and sales made for the sole purpose of influencing the level of prices will, so far as they are successful, create an unnatural and unjust price. They are substantially attempts at an immoral monopoly.

A favorite method of manipulating values is to disseminate false reports concerning property or market conditions. A description of the various ways in which this scheme is practised is not possible nor necessary here, but a typical instance may be given. In the spring of 1900 a prominent manufacturing company having its headquarters in New York, sent out a report that a dividend was to be immediately declared on its stock. This caused the stock to rise several points, and the

directors and their friends then "sold for a fall." Next the report concerning the dividend was denounced as false, and official announcement was made that the company's condition did not warrant the payment of a dividend. Immediately values began to fall, and those who had sold "short" bought in at a profit, while the small holders of stock became panic stricken and sold their holdings to the larger ones. This last phase of manipulation, which consists in depressing values for the purpose of getting possession of the stock of the small holders, is expressively termed "shaking out."

The industrious circulation of false reports is an essential part of the process known as "supporting." The owners of some stock that is worth little send out glowing accounts of its desirability as an investment, and of the earning capacity of the property that it represents. At the same time they begin to make purely speculative purchases on a large scale. The intention is to deceive the public into the belief that the owners have confidence in the future of their own property. The result is that the price of the stock rises. When it has reached what the conspirators regard as its maximum, they sell both their cash stock and their purely speculative purchases to a confiding public. Then the stock rapidly sinks to its proper level.

Another way of manipulating is by "wash sales." One or more operators scheme to depress the quotations of a particular stock by making a show of enormous sales. The natural effect of such wholesale selling when reported on the stock market is to cause a fall, but the peculiarity of these transactions is that they are not sales at all, for the same person is both buyer and seller. He employs two brokers, one of whom sells to the other. Thus the supposed sales are all counterfeit, since the supposed buyers have no existence. The same principle can be carried out in attempts to *inflate* values, and in the case of produce, as well as stock.

A simpler form of manipulation is the attempt to raise or depress the value of a stock by extensive genuine buying or selling. Where several operators act together the operation is called a "pool." An extreme instance of continued buying

for a rise is the "corner." If it is successful the result is that one or a few men get control of sufficient of the available supply of a certain produce or stock to create what is practically a monopoly, and thus force up prices almost at will. The corner, however, is rarely successful.

The schemes above described are some of the more common forms of manipulation. Clearly they are all immoral, and the gains accruing from them dishonest. Closely allied to false rumors as a source of unjust profit, is the special and secret information that is so often turned to account on the exchanges. When this special information concerns a movement of prices that will come about naturally, not artificially, and when the information is acquired by the expenditure of some labor, either intellectual or physical, or when the information is not entirely certain,—there would seem to be nothing wrong in making use of it for profit. But it is difficult to see how the profit will be honest if any of these conditions be wanting. Suppose that a certain stock is about to be manipulated upward. Now if an "outsider" is apprised of this fact, and buys some of the stock to sell at the advance, he is simply realizing unique possibilities of stealing. He defrauds the other party to the contract; for artificially produced gains for one man mean, in the long run, artificially produced losses for another. But suppose that an advance in the price of a certain property is due to the natural laws and conditions of trade. In that case a man who foresees the advance by reason of exceptional skill and diligence in studying the conditions of the market, may rightfully invest in the property, and reap a profit that will be in some sense the reward of ability. Again, if a man without exercising labor or skill obtains special information that is not entirely trustworthy, his gains from a speculation made on this basis might be regarded as the reward of risk-taking. But if the information is practically certain, and got without any personal expenditure of any kind, the morality of gains coming even from a natural movement in prices will usually be very questionable. Obtained as they are from differences in price, their source will in most cases be the pocket of some one who is not possessed of this special knowledge. The

transaction is substantially a wager in which one party takes the other at a disadvantage. These are the principles: in practice it would seem that most of the profits arising from secret information on the exchanges are unlawful.

To what extent do manipulation and the various other forms of immoral speculation prevail? A precise and definite answer to this question is, of course, not obtainable, but it is safe to say that on the more prominent exchanges of the country questionable methods are in very common use. "Schaeffle, who is not only an eminent political economist, but has been minister of commerce to one of the great political powers of Europe, says that when he became acquainted with the bourse he gave up believing any longer in the economic harmonies, and declared theft to be the principle of modern European commerce."* A member of the New York Stock Exchange declared a few months ago that fifty per cent. of the operations in that institution were attempts to manipulate prices. The manœuvers of the great operators have often been compared to a game in which the successful players use loaded dice or marked cards. Indeed, many close observers of the speculative market assert that in the long run money is made only by those who resort to questionable devices. This is probably an exaggeration, but we can readily see that when men having great power, the big operators, are engaged in operations whose success depends solely on the movement of prices, they will be strongly tempted to use their power in order to influence this movement. It is impossible to watch their tactics for any length of time without concluding that they regard manipulation in some form as an essential feature of speculative operations. The stock market columns of almost any morning newspaper will show that on the preceding day there was "an assault by the bears" on this or that stock, and that under "constant hammering" the stock fell one or more points. Or, we are informed that "after a rally by the bulls," such a stock "went skyward."

So far, at least, as the big operators are concerned, the ex-

*John Rae, "Contemporary Socialism," p. 326.

change is a battlefield on which two opposing armies, the bulls and the bears, are constantly engaged at close range. "All is fair in war," and it is not surprising that in the speculators' warfare nice ethical discriminations as to methods should be overlooked. Manipulation is regarded as lawful, since it is merely fighting the enemy with his own weapons. The intellectual atmosphere of the bourse is so befogged that the moral vision of its habitues becomes easily dulled. The mental qualities that are most frequently called into play among professional speculators are those that characterize the activities of the professional gambler. "A man's nerve is put to the highest tension; his mind is always on the stretch; not guiding the policy of a great commercial venture, but bearing up under, and watching over, the fluctuations of some stock which, in the opinion of the majority, and by virtue of what has been paid for it at the outset, is worth only so much, and which he has estimated at a different value. The trade is not a noble one, and there are few noble men engaged in it."*

So much for practices of speculation that are certainly dishonest: what about the acts of a speculator who has no desire to take advantage of any unlawful practice? Is it wrong to make a purchase or sale on the exchange solely for the purpose of realizing a profit out of a change in prices? The purchaser or seller, we will suppose, seeks no dishonest advantage, but is willing to take all the risks of an unfavorable turn in prices. We cannot say that such a transaction is, in itself, wrong. At the worst it is merely a wager on prices, and wagers are not immoral, provided: (1) that those who take part in them have the right to dispose of the property that they hazard; (2) that neither fraud nor violence be used; (3) that the chances for winning be approximately equal, so far as the knowledge of the participants is concerned; (4) that the parties risk no more than they can afford consistently with the duties of their condition and calling; and (5) that the transaction in question is not forbidden by the positive law. All of these conditions may easily be present in a speculative

*Frazer's Magazine, vol. 94, p. 84.

deal; consequently there may be nothing in it contrary to the moral law. This statement applies to an act of speculation in the abstract, not in the actual conditions of to-day.

For we have seen that from the side of economic welfare the whole institution of non-productive speculation is in all probability useless; that from the side of social welfare it is productive of grave evils; and that from the side of morality its transactions are to an alarming extent carried on by dishonest methods. In the light of these facts, we may safely conclude that, so far as the principal exchanges of the country are concerned, it is morally impossible for a man who spends all or the greater part of his time speculating, to avoid all the dishonest practices of speculation. Secondly, we would seem to be justified in asserting that men who, even without any intention to be dishonest, participate to *any* extent in speculative transactions on these exchanges, are engaging in actions that are, at least, *morally questionable*. As we said above, the isolated act of speculation may in itself be without censure—may be no worse than the placing of a wager—but because of its connection with a questionable institution, and because of its grave danger to the individual himself, it can never be pronounced licit in the sense that the transactions of ordinary trade are licit. The shadow of immorality is over it always. Every speculative deal is a participation, remote and insignificant, perhaps, in what can without exaggeration be regarded as a social and moral evil, namely, the institution of organized speculation.* Every anticipated profit, almost, is in danger of being promoted by illicit manipulation; for the well meaning outsider can seldom be certain, even if he tries, that movements of price by which he is the gainer, have not been artificially produced. Every man who yields to the seductive temptation to speculate feeds the passion of avarice, strengthens the ignoble desire to profit by the losses of his fellows, cultivates a dislike for honest, productive labor, and exposes himself to financial ruin. Hence, no man who is fully acquainted with

*For a strong confirmation of this view, see A. Crump's well-known work, "The Theory of Stock Speculation," recently reprinted in the "Wall Street Library" series.

the character and effects of speculation, and who is possessed of a fine moral nature, will ever participate in the purely speculative operations of either the stock or the produce exchanges of our largest cities.

The question, "Is speculation wrong?" cannot, therefore, be answered categorically. The phenomena with which it deals are too complex. But with the help of the distinctions above drawn an answer may be obtained that is fairly definite. To resume, then: speculation as an institution is *economically* of doubtful utility; *socially*, it is productive of great and widespread evils; and *morally*, it is vitiated by a very considerable amount of dishonest "deals" and practices. As an individual action, speculation, at its best, is morally questionable.

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THE PLACE OF ETHICS IN THE TABLE OF THE SCIENCES.

A Swiss professor recently compared the philosopher to an Alpine traveler who with infinite pains had at length succeeded in reaching the summit of some very high mountain. On looking around him he found he could no longer distinctly see some of the smaller objects which had formerly occupied the largest share of his attention. The cottage in the valley which he had left, the wife from whom he had parted on the previous day had faded into a thin mist; but instead of them he was able to discern the larger contours of hill and valley and lake in a manner which he had never previously been able to do. The illustration is a very appropriate one to bring before our minds the work of the investigator who is interested in the larger relations of his special department to the general theory of knowledge. In these days we must either be content to keep to the valleys and remain imprisoned in the roomy cell of our own special subject or else we must be prepared now and then to risk an expedition to the mountain tops so that we may become more familiar with the relations of our special subject